

## BENCHMARKING AS A RESEARCH METHOD FOR OBTAINING SYSTEM KNOWLEDGE OF THE STATE INSTITUTIONAL DEVELOPMENT

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**Abstract:** *The article looks at current central issues of modernization of the country's socio-economic system institutional structure within the context of the EU, Georgia Association Agreement, and conceptual and methodology benchmarking issues related with the same. For monitoring of the institutional development, possibilities are shown for the use of current international indicators including the economic freedom index.*

**Key words:** *Globalization, EU, benchmarking, modernization of institutional structure*

**ITHEA Keywords:** *I.2 Artificial Intelligence; D.2.2 Design Tools and Techniques*

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### Introduction

European orientation of Georgia stresses the urgency of a systematic and effective consistent integration of our country in the EU and Euro-Atlantic structures. At the same time, there is certainly the expectation in the Georgian society that the new European potential will be used for the country's socio-economic development in the modern and global conditions.

By reference to the characteristics of the EU, as a socio-economic system, and due to Georgia's current and future multilateral correlation positions in the framework of the Association Agreement [Georgia-EU Association Agenda, 2014], first of all, it is important for our country to identify challenges and to develop and implement relevant social and economic policy based on the same.

In our opinion, proper understanding of the issues and their consistent solution is possible only with the institutional approach. It is transformation of the institutions which is a really important foundation for Georgia to benefit from the EU and its business environment potential [Bedianashvil, 2014]. We believe that the urgency of the institutional approach casts no doubt as world-known researches have proved that predominantly institutional factors were involved in the formation of different levels of development between countries during long historical periods.

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## Literature review

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The most important issue is that the process of creating institutions (institutionalization) must be systemic and synchronous in the dynamics (time). **It should be noted that institutionalization ultimately means changing of spontaneous and experimental behavior to regulated, expected and predictable behavior.** In addition, due to the positions of effective functioning of institutions in the process includes (theoretically and methodologically must be separated) several interrelated stages, such as: **Development (identification) of demand** which requires organized joint (**not spontaneous**) activities from humans; **Development of standards and regulations in the process of natural social and economic interaction; application of sanctions imposed for the promotion of such regulations;** Determination of **respective status and roles** for each member of the institute; **Establishing formal and informal organizations, which will regulate the institute activities.** Thus, it can be said that in case of institutionalization, institutions (primarily economic institutions, but not only) are "cultivated" locally and not imported from outside i.e. "transplanted" (see [Полтерович, 2001] for economic transplantation of institutions). As the transformation practice of post-communist period shows, import of institutions to other countries, when an imported institute evolved for many years and functioned efficiently in a qualitatively different environment other than the "importer" country, in most cases, tends to yield no desired results, which is due to a number of reasons (the complex analysis of the same is provided in the paper [Papava, 2014], and some important aspects of institutional analysis of economic transformation is explored in the paper [Papava and Khaduri, 1997], in this regard the interesting papers are as well [Asatiani, 2014] and [Tokmazishvili, 1997]).

The key to the issue of institutionalization in our view is an adequate measurement of the development level of the institutional structure (the main structural component which ensures effective functioning and complexity of dynamics of the country's socio-economic system) [Bedianashvili, 1995]) to provide effective monitoring of development and functioning of institutions, as well as to determine a specific country's state with regard to other countries (benchmarking).

It logically raises the question about the EU's business environment, also the compatibility of institutional structures of the socio-economic systems of the EU countries and Georgia. Therefore, it is of great importance, if necessary, to determine certain directions for institutional changes, and their practical and systemic implementation.

As mentioned above, the mechanical copying of institutions is not effective for the country. Based on the logic of systemic institutionalization, the first phase should include identification of needs and relevant problems, which could be solved with an institutional approach (arrangement). In this respect, we think it is recommended to consider the areas where the country is experiencing a significant lag, which essentially prevents the country's socio-economic development and probably business operations.

For Georgia's institutional benchmarking purposes, we will choose Switzerland (a European country with effective institutional arrangement, although not a EU member) and Estonia. The efficiency of the institutional structure, we think, can be indirectly measured by the country's sustainability level in extreme (crisis) periods (generally, with the economic theory instrumentals for measurement of institutions, previously argued by R. Matthews [Matthews, 1986]). Indeed, Switzerland shows quite good dynamics during the 2008 crisis and the following periods, and Estonia also has the favourable characteristics upon the post crisis stage (see, for example, the statistical data [The World Bank, 2017]). Here, it is interesting to bring up a question: is economic development level important for the quality of its economic dynamics sustainability? In general, of course, it is, but not decisive. The effectiveness of the institutional structure is more significant, we believe. This is clearly evidenced in the Euro Zone and some countries, for example, USA, China, Turkey, Japan (the statistical data applied [The World Bank, 2017]).

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#### Data and methodology/Analyses

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As for the institutional structure, as the country's socio-economic development sustainability ensuring factor, as noted above, in our opinion, the key is identification and monitoring with, for example, the Index of Economic Freedom, which has been developed (calculated) annually by **The Wall Street Journal** and Research Center **Heritage Foundation** since 1995 in the light of most countries of the world. [Index of Economic Freedom, 2017]. Indices are published once a year and as of 2017 data cover 186 countries.

Economic Freedom Index is designed to reflect important institutional characteristics required for any country's economic growth. The indicator includes dozens of indicators, which are united in the following 12 groups (quantitative and qualitative factors): **1.Property Rights; 2.Government Integrity; 3.Judicial Effectiveness; 4.Government Spending; 5.Tax Burden; 6.Fiscal Health; 7.Business Freedom; 8.Labor Freedom; 9.Monetary Freedom; 10.Trade Freedom; 11.Investment Freedom; 12.Financial Freedom.** The indicators are placed in 4 groups: Law and Order (1; 2; 3), Government Size (4; 5; 6), Regulatory Efficiency (7; 8; 9), Markets Openness (10; 11; 12). Each of the above score is measured from 0 to 100. For this purpose 100 corresponds to maximum freedom, and 0 - minimum. Each factor in the above ten is included with the equal weight into the integral indicator (economic freedom index), which is calculated as arithmetic average.

According to the quantitative values of integral indicators, the world countries are divided into five respective groups with their Economic Freedom levels: **Free**, a range of 80-100; **Mostly Free**, a range of 70-79.9; **Moderately Free**, a range of 60-69.9; **Mostly Unfree**, a range of 50-59.9 and **Repressed**, a range of 0-49.9.

**Discussion of results**

According to the 2017 data, Georgia belongs to the group of countries with mostly free rating as it moved from the last year's 23<sup>rd</sup> place to 13<sup>th</sup> in the world, while among 44 European countries it already takes the 5<sup>th</sup> place. Pursuant to the **Economic Freedom Score** (76), it stands alongside with the countries such as Taiwan (76.5), the United Kingdom (76.4), Luxembourg (75.9) and the Netherlands (75.8). For example, the United States is rated 17, while the corresponding score is 75.1. As for the top five countries, they are: Hong Kong (89.8), Singapore (88.6), New Zealand (83.7), Switzerland (81.5), Australia (81.0). It should be noted that the world average score is 60.9 (which corresponds to the level of moderately free score), and the average regional (European) is 68.0 (also moderately free country level with freedom level higher than moderate world average score). Thus, Georgia according to its Economic Freedom integral indicator takes higher position in the region (in Europe) and the world.

For years, unfavorable lower level of systemic institutionalization has been observed in Georgia, although some subsystems of institutions were evolving quite rapidly. It should be noted that according to 2017 data (Fig.1), Georgia's state has significantly improved compared to previous years, but still it lags behind the benchmark and leading European countries in terms of development of market openness (investment freedom and financial freedom), also Law and Order (property rights, government integrity and judicial effectiveness) institutions.

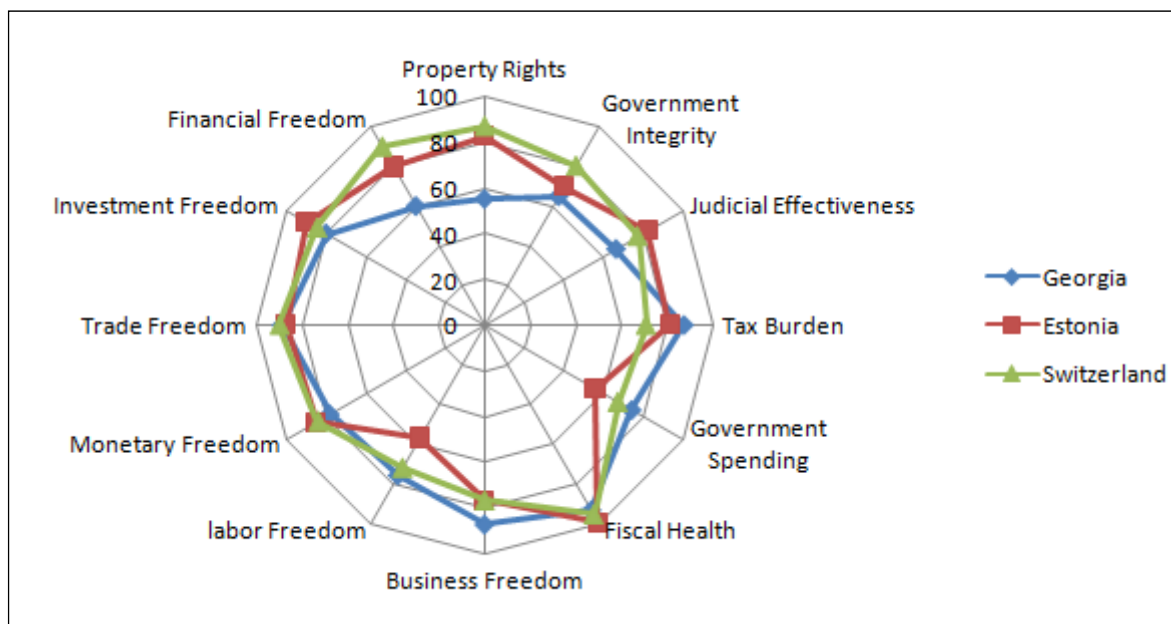


Figure 1. The institutional development complexity level of Switzerland, Estonia and Georgia

As noted in the 2017 research, the "open" market policy in Georgia, accompanied by a relatively low tax rates and a higher level of regulation, has promoted the development of trade and investment growth. Monetary stability and "healthy" fiscal policy has contributed to the country's macroeconomic stability. Despite the positive changes, profound and rapid institutional reforms are still urgent, especially in terms of strengthening the judicial independence. This in turn ensures the acceleration of country's development.

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### Conclusions

We believe that a gradual reduction of the above mentioned lag should be one of the main directions of systemic institutionalization of our country in the coming years. This will allow to fully use modern European institutional structure and the EU business potential for our country's socio-economic development. The implementation of a complex of activities has already been included in Georgia-EU Association agenda [Georgia-EU Association Agenda, 2014], as well as in the socio-economic development strategy of Georgia (2020) [The socio-economic development strategy of Georgia, 2014].

One can confidently say that Georgia is facing fundamentally new challenges, and in our opinion, the key for our country, which is a part of Europe, is to manage and establish closer ties with the European countries within globalization processes taking place in the world in parallel with mutually beneficial and pragmatic cooperation with other countries. In addition, the focus must be placed on strengthening of objectively positive aspects of our own state social and economic system, and transforming of negative and weak elements of our society with a consistent and clear, acceptable and painless for the society methods and forms. At the same time, we should take into account Georgia's own national and world civilization centuries-old experience of the past and best samples and models of modern periods.

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**Major Fields of Scientific Research:** System analysis, Institution economics, Econometric, methods of socio-economic policy, global business